Testimony of Chris DiAngelo
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Chairman Frank, Ranking Member Bachus, Members of the Committee, I appreciate the opportunity to discuss the topic of the Commercial Real Estate Stabilization Act today. I am a partner at the law firm of Dewey & LeBoeuf LLP, and I have been involved in the mortgage finance business for 30 years.

Thank you for the opportunity to address the challenges in the commercial real estate market from a business and legal standpoint. Rep. Minnick and his team reached out to us in February of this year as the ideas behind CRESA began to mature and take shape. Throughout this process, Mr. Minnick took a grassroots approach to formulating the policy behind the bill and his team has consulted a large, varied array of industry groups, trade groups, practicioners, attorneys and regulators. This problem is large enough in scope that no single piece of legislation will fully create a market rebound; there is no silver bullet. However, I believe the bill we're discussing today is a pragmatic, workable solution which will positively impact as many market participants as feasible. For those entities unable to avail themselves of the CRESA program, we anticipate that general improvements in the CRE market attributable to CRESA will have a ripple effect to the entire commercial real estate market at large.

First, I am going to briefly discuss why this bill is both vital and timely to effectively address the CRE crisis. Second, I am going to discuss the problems unique to the small balance CRE and community bank space. Finally, I am going to discuss why the CRESA program will contribute to a much-needed economic recovery in the CRE markets.

1) Existing Government Solutions to Aid the CRE Market have not Succeeded

I see this piece of legislation as a key element to jumpstart the recovery in the commercial real estate market by targeting important issues that have received less press and attention in the recent turbulent years in the credit markets. Importantly, government programs to date have not been able to impact the $1.3 trillion in commercial real estate loans which are coming due or need to be refinanced in the next five years. The most targeted of the past programs with regard to commercial real estate was the TALF CMBS program. This program, which expired on June 30, 2010, provided TALF loans only for "AAA" rated CMBS securities, and the loans were only for five years. Less thank $15 billion in TALF loans were requested for CMBS, and almost all of that was used for the "legacy CMBS" program for existing CMBS, and not involving new loans. Another program aimed at commercial real estate, the "Legacy Loans PPIP" ("PPIP" for Public-Private Investment Program) was announced in March 2009 and essentially abandoned three months later. The government's SBA programs are not large enough to handle this problem and have a maximum size that will not cover the bulk of today's CRE issues.

The SBLF which passed the House at the end of June provides incentives for banks to resume small business lending; the Senate is currently in the process of considering the SBLF, which passed the House on June 21st. Through the introduction of the SBLF bill, the Administration has sent a loud message that the forecast for small business and small business lending remains bleak and requires intervention. The SBLF provides for direct capital injections into community banks, and while it may prove to be a useful tool to create more small business lending than exists at present, we think a broader push which will rebuild the pieces of the securitization engines gradually and

prudently, in a scalable and appropriate fashion, is exactly what the current regulatory and legislative environment needs.

2) Community Banks and Small Business are at the Epicenter of the CRE Problem

Those community banks with $10 billion dollars or less in assets on their balance sheets are the financial institutions who have carried so many of the defaulted commercial real estate loans on their books. As community banks are a primary source of providing loans to small businesses, it is no surprise that small businesses across the country have been suffering. Many of these loans are small-balance commercial real estate loans. Put another way, much small business lending in this country takes the form of commercial real estate lending.

Community Banks are being pushed by their regulators to get CRE loans off their balance sheets; those banks were so heavily concentrated in certain CRE loans in the first place because those were the only products available and/or affordable to them, when competing with larger financial institutions, both larger banks as well as the GSEs. The smaller banks in this country have found themselves in a catch-22 in that regard, and have stopped making loans to small businesses and other important, job-creating sectors of our economy – without those loans to keep the economy moving, the downturn will be difficult to turn around in the near future. It is worth noting that time, however, is of the essence. If the credit market does not begin to function more efficiently, many CRE assets could drop in value as much as 70% by 2011, from 2007 levels. Additionally, as of today, many market players are purchasing CRE assets, in cash, at 20-40% of replacement value.

The current state of community banks boils down to the weekly FDIC announcements regarding closures and banks under watch. In many cases, the underlying problems at these banks are rooted in commercial real estate. As losses from bank closures have been rolling to the FDIC's deposit insurance fund, it is important to note that the government, via the deposit insurance fund, is already shouldering this mounting burden. As the FDIC's resolution authority only activates upon a bank seizure, we believe a more proactive measure is required, since if the problem can be addressed earlier – before the bank is seized – it can probably be addressed more effectively, and at a lower cost. The FDIC was not designed to handle the situation we are now facing – a lack of liquidity in the credit markets. However, unlike the FDIC, the Treasury and other arms of the government and legislative bodies are better suited to draw a line in the sand and to implement a new vehicle to stop the vicious cycle of frozen credit, bank failures, job losses and devaluation of CRE which the nation has been facing.

3) Utilizing Securitization to Stabilize the Value of CRE

I have worked in the securitization markets for over 20 years and I can attest that there is no more powerful and elegant tool in the capital markets to make consumer finance more affordable, create bonds for different risk appetites, and create a lucrative, steady payment stream for issuers and sponsors of asset-backed securities and purchasers of bonds backed by those securities. Although many have pointed their fingers at securitization during the subprime crisis and related credit meltdown, the financing techniques of securitization have continued to prove themselves to be a superior means of financing consumer loans and leases, across many asset classes, in the capital markets,

and this observation has been made repeatedly by Chairman Bernanke, Secretary Geithner and Chairman Bair.

Unlike the SBLF, the power of the Treasury's bond guarantee under CRESA takes on the problems of the CRE market from a different tack. CRESA attempts to cast a wider net than the SBLF by utilizing a Treasury guarantee which can be used by all originators, although 50 percent of the program's capacity will be reserved for community banks. SBLF provides for direct capital injections, and only at community banks. Being a guarantor on the principal and interest of bonds is a lucrative business; under CRESA the Treasury will in all likelihood bring profits to the government without any cost to the taxpayers, and create liquidity in a troubled sector of the market in the interim (as an intended consequence).

CRESA is designed to restore liquidity and prudent leverage in the capital markets. Values of commercial real estate will not return to the highs before the boom, the Bill does not seek to accomplish what the market could not or would not be able to support in a functioning credit market scheme. Rather, CRESA tries to stop the devaluation of CRE values and return the value of those underlying assets to the levels (or a portion of the levels) at which those loans should be, if the economy and the market were functioning correctly and more efficiently. Once liquidity is introduced, banks (both small and large) will be able to re-commence prudent lending practices. The regulators will no longer require those banks to de-lever their balance sheets, thus creating more space for lending to small businesses and those institutions looking for a loan to invest in commercial real estate. With those changes, the value of commercial real estate will begin to rise from its currently depressed state. Once the current cycle of

artificially depressed CRE values and frozen lending begins to crack, the market will have the requisite liquidity and momentum to begin to self-correct and slowly rebuild the pieces of the CRE market. At that juncture, which we hope will be accomplished shortly after the implementation of CRESA, the government guarantee will not be utilized and the private market will be able to step into the CRE space and begin to revive CMBS transactions and the commercial real estate market overall.

Conclusion

Thank you for the opportunity to present these views regarding the Commercial Real Estate Stabilization Act. I look forward to working with you and the Committee further to assist the implementation of this key piece of legislation.